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SUBJECT: SERBIA AND THE IMF REACH AGREEMENT ON A STAND-BY  
ARRANGMENT

SUMMARY

1. (U) Serbian Government announced on November 14 an agreement with the IMF on a new 15-month \$516 million Stand-By Arrangement. The Finance Minister highlighted that the arrangement was a stand-by arrangement and that Serbia would withdraw funds "only if needed." She also announced a cut in public spending by 1.5% of GDP for 2009, mostly through a cut in subsidies and "better management." The IMF was not concerned about Serbia's financial situation in the short run due to "comfortable reserves and continued access to external financing," but characterized Serbia as vulnerable in the medium term due to the high current account deficit, weak export base, and low savings rate. The new agreement provided flexibility to respond to shocks and increased investors' confidence, according to the Finance Minister. END SUMMARY.

Stand-By Agreement Signed

2. (U) The Serbian Government and the IMF representatives announced at a joint press conference on November 14 that after prolonged two-week negotiations they had finally reached the agreement on a new 15-month Stand-By Arrangement (SBA). The agreement was precautionary, since it only provided the option for Serbia to withdraw \$516 million (75% of Serbia's IMF quota) if needed. Serbian authorities "do not intend to withdraw funds due to comfortable reserves and continued access to external financing," according to the IMF statement. The agreement is subject to approval by IMF management and the Executive Board. The IMF plans to bring the agreement to the Board on December 19, 2008.

Finance Minister: Program Includes Broad Cuts

3. (U) Finance Minister Dragutinovic said at the press conference that the program was the state's response to worldwide crisis. Program elements included savings on all levels of state spending - central government, municipalities, and mandatory social insurance funds - but only on current expenditures, while capital investments remained generous. This required fiscal adjustment in 2009, with a decrease of 1.5% in public consumption to reach 44% of GDP or, in absolute terms, a decrease of around \$740 million. The fiscal deficit of 1.5% of GDP comes as a consequence of the slowdown in economic growth - revised to 3% in 2009 - and not as a consequence of expansionary fiscal policies. If growth were 7%, as planned as late as August of this year, there would be no deficit, said Dragutinovic.

Despite Savings, Pensions and Salaries Will Increase

4. (U) Dragutinovic said that the total budget for salaries and pensions would increase moderately in 2009, by 8% and 15%

respectively. Savings would be made in subsidies, which would go down significantly from the current level of over 2.5% of GDP to approximately 1% of GDP, mostly through cuts in the Development Fund, Transition Fund, agriculture subsidies, public companies (especially the railway), and local-level utility companies. The Minister also announced stricter controls on expenditures, such as official travel and other non-recurring purchases, and promised to freeze those at 2008 level. The government estimated that the current account deficit should fall from 18% of GDP in 2008 to 16% of GDP in 2009. The IMF agreement was "preventive", provided greater flexibility to absorb possible shocks, and increased investors' confidence, according to Dragutinovic.

IMF: Not Worried on Short Run, Vulnerable Beyond It  
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15. (U) According to the IMF press release, the program includes fiscal restraint - a fiscal deficit limited to 1.5% of GDP in 2009; monetary policy focused on restraining inflation; financial sector measures to maintain stability; and structural reforms to boost economic growth. The IMF team leader reiterated that that this was not an emergency program, but rather a standard stand-by arrangement. For the short term IMF was not too concerned: the banking system had high liquidity, the capital adequacy ratio was high, and short-term external debt was low. However, in the mid-term Serbia was vulnerable due to the high current account deficit (Serbia spends \$7.5 billion more than it earns every year), a weak export base, low savings rate, and structural problems of the oversized public sector.

Governor Jelasic: Jointly to Control Inflation  
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16. (U) National Bank of Serbia Governor Jelasic announced that NBS remained focused on low inflation and that NBS and the government would sign a memorandum of understanding in a joint effort to control inflation - using consumer price index targets, rather than the current core inflation targets that exclude most private-sector set prices. The inflation target for 2009 would be 8%, plus or minus 2%. The Governor also restated his desire to develop a dinar-based securities market in the medium term.

COMMENT  
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17. (SBU) Several local bankers told us that the IMF agreement was a very positive development that would help stabilize the Serbian market in the short term. The government faces a real challenge to spread the pain of spending cuts while keeping the governing coalition together. Contacts in the Ministry of Finance and Deputy Prime Minister Djelic's office told us that the government had struggled to reach agreement on the budget deficit. The government delayed its regular session to hammer out the final agreement, and the press and our contacts reported significant pressure from and on the Pensioners party. It is still not completely clear what the Pensioners party accepted as part of the deal. The IMF agreement gives the government an additional cushion to react to the global financial crisis, but without structural reforms and judicious fiscal policy in the coming year, Serbia could still become another victim in the financial downturn.

MUNTER